

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:04
PLR-117263-06

Date:
April 04, 2007

Legend:

Trust =

Family Trust =

Decedent =

Child 1 =

Grandchild 1a =

Great Grandchild 1a1 =

Great Grandchild 1a2 =

Great Grandchild 1a3 =

Grandchild 1b =

Grandchild 1c =

Great Grandchild 1c1 =

Great Grandchild 1c2 =

Great Grandchild 1c3 =

Grandchild 1d =

Great Grandchild 1d1 =

Great Grandchild 1d 2 =

Great Grandchild 1d 3 =

Child 2 =
Grandchild 2a =
Great Grandchild 2a1 =
Great Grandchild 2a2 =
Trust 1a =
Trust 1b =
Trust 1c =
Trust 1d =
Trust 2a =
Foundation 1 =

Foundation 2 =

Date 1 =
Date 2 =
Date 3 =
State =
State Statute =
State Court =

Dear :

This letter is in response to a letter dated February 10, 2006 from your authorized representative requesting rulings concerning the income, gift, and generation-skipping transfer (GST) tax consequences of the division of Family Trust.

The facts and representations submitted are summarized as follows:

On Date 1, prior to September 25, 1985, Decedent, as settlor, established Trust, an irrevocable trust. It is represented that no actual or constructive additions have been made to Trust since Date 1. Under Paragraph 2 of Trust, for an initial term of fifteen years, all of Trust's net income is to be distributed at least annually to charitable, religious, and educational organizations described in section 170(c)(2) of the Internal Revenue Code to be selected periodically by the trustees.

Paragraph 3 provides that on the expiration of the fifteen-year charitable term, the trust corpus is to be held in further trust designated as the Family Trust. The Family Trust is to be divided between two equal separate trusts, Child 1's Division and Child 2's Division.

Paragraphs 4 and 5 of Trust provide identical substantive provisions (except for the beneficiaries) for Child 1's Division of Family Trust and Child 2's Division of Family Trust, respectively.

Paragraph 4 of Trust provides that so long as Child 1's Division of Family Trust continues, the trust estate is to be divided into shares, reconstituted and redivided so that the separate shares (held as separate trust estates) will be then constituted in the same manner as if the assets of the division were about to be distributed to the then living descendants of Child 1 per stirpes. The "primary beneficiary" of each share is defined as any living descendant of Child 1 who in the event of such distribution would be regarded as entitled to be a distributee of a particular share in accordance with the principles of distribution per stirpes.

Paragraph 4 further provides that the trustees, in their discretion, are to accumulate the net income of each separate share of Child 1's Division of Family Trust and add the income to principal, or pay the net income of each separate share to one or more or all of the class consisting of the primary beneficiary of that separate share, the then living descendants of the primary beneficiary of that separate share, and Child 1, in such amounts as the trustees determine with regard to the needs and circumstances of the beneficiaries, including their accustomed standards of living and their other circumstances.

Under Paragraph 4, Child 1's Division of Family Trust is to terminate on the first to occur of : (i) the expiration of twenty-one years after the death of the last to die of Child 1 and Child 2, and the descendants of Child 1 and Child 2 who were living on the date of creation of Trust; (ii) the date termination, vesting or distribution is required to avoid violation of any applicable rule against perpetuities; (iii) the time as the trustees, in the exercise of their discretion, determine that in view of existing social, political or economic conditions it is in the best interests of the then living beneficiaries to effect a termination; (iv) the time as neither Child 1 nor any descendant of Child 1 is living.

Upon termination, the trustees are to distribute the assets of Child 1's Division outright to the then living descendants of Child 1, "in equal shares to those in the nearest degree of relationship to [Child 1] and by right of representation to those in more remote degree of relationship". The Trust instrument provides an example of the operation of this provision, as follows: If on termination there are five living grandchildren of Child 1 and their respective issue (all Child 1's children having predeceased) each grandchild will receive one-fifth of the trust corpus. However, if on termination, there are two living grandchildren and two great-grandchildren who are issue of a predeceased grandchild, then the share of each grandchild will be one-third and the share of each great-grandchild will be one-sixth.

If no descendants are then living, the assets are to be distributed to Child 1. If Child 1 is also not then living, the assets are to be added to Child 2's Division of Family Trust. If there are also no beneficiaries under Child 2's Division of Family Trust, the assets are to be distributed to Foundation 1. If Foundation 1 is not in existence, the assets are to be distributed to Foundation 2.

As noted above, Paragraph 5 of Trust contains identical provisions governing the terms of the Child 2 Division of Family Trust, except that the beneficiaries are Child 2 and Child 2's descendants.

Currently, Child 1 is living and has thirteen living descendants: Grandchild 1a and his children, Great Grandchild 1a1, Great Grandchild 1a2 and Great Grandchild 1a3; Grandchild 1b; Grandchild 1c and her children, Great Grandchild 1c1, Great Grandchild 1c2 and Great Grandchild 1c3; Grandchild 1d and her children, Great Grandchild 1d1, Great Grandchild 1d2, and Great Grandchild 1d3. Child 2 is deceased and has three living descendants: Grandchild 2a, Great Grandchild 2a1 and Great Grandchild 2a2 (the children of Grandchild 2a). In addition, there are four living persons who are measuring lives for purposes of the perpetuities period: Child 1 and three of his children, Grandchild 1a, Grandchild 1b, and Grandchild 1c.

Since Date 2, when Trust's charitable term expired, in accordance with Paragraphs 4 and 5, the trustees have divided the Child 1 Division into separate shares, and administered each separate share as a separate trust. Specifically, the Child 1 Division is administered as 4 separate trusts, Trusts 1a, 1b, 1c and 1d, of which Grandchild 1a, Grandchild 1b, Grandchild 1c, Grandchild 1d, are the respective primary beneficiaries. The Child 2 Division is held in one trust, Trust 2a, of which Grandchild 2a is the primary beneficiary.

On Date 3, pursuant to the trustees' petition, State Court issued an order formally dividing Family Trust into the five separate trusts as currently administered, Trusts 1a, 1b, 1c and 1d and 2a. Under the court order, as a result of the partition, the provisions of the Trust agreement requiring that each division of the Family Trust be reconstituted and reddivided from time to time no longer applies between any separate partitioned trust and any other separate partitioned trust. Further, under the court order, the provisions of the Trust agreement regarding termination will apply with appropriate adjustments to reflect the fact that each partitioned trust is a separate trust. Under this provision, upon termination, the terminated trust would be distributed to the primary beneficiary of the trust, if living, or if the primary beneficiary is not then living to that primary beneficiary's descendants per stirpes. In all other respects, the dispositive terms of the partitioned trusts will be the same as provided under the terms of Family Trust. The court order is subject to the trustees obtaining a favorable determination from the Internal Revenue Service concerning the income, gift, and generation-skipping transfer tax consequences of the division of Family Trust.

Paragraph 10(12) of Trust provides that the trustees have the power to make division of the trust estate, when division is required, wholly or partly in kind on the basis of values as determine by the trustees. State Statute provides that a trustee may, without the approval of any court, divide a trust, before or after it is funded, into two or more separate trusts if the trustee determines that dividing the trust is the best interests of all persons interested in the trust and will not substantially impair the accomplishment of the purpose of the trust.

The trustees request the following rulings:

1. State Court order will not cause Family Trust or the resulting partitioned trusts to lose their exempt status for generation-skipping transfer tax purposes and will not subject either a distribution from or termination of any interest in the family trust or the resulting partitioned trusts to the GST tax under § 2601.

2. State Court order will not constitute a transfer by any beneficiary of Family Trust or of the resulting partitioned trusts that would be subject to gift tax under § 2501.

3. State Court order will not result in the realization of any income, gain, or loss under §§ 61 or 1001 by Family Trust, the resulting partitioned trusts, or a beneficiary of Family Trust or of the resulting partitioned trusts.

Ruling Request 1

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under section 1433(a) of the Tax Reform Act of 1986, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for

vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification that does not result in an increase in the amount of a GST transfer or the creation of a new GST transfer will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(E), Example 5, involves a trust that is irrevocable on or before September 25, 1985. The trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and corpus to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust is to terminate and the corpus distributed to A's issue per stirpes. The terms of the trust for B and B's issue are identical except for the beneficiaries. The example concludes that the division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In this case, Trust was irrevocable on September 25, 1985. It is represented that no additions have been made to Trust after that date. The proposed partition of Family Trust into Trust 1a, Trust 1b, Trust 1c, Trust 1d, and Trust 2a in accordance with State Court order will not shift a beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the partition will not extend the time for vesting of any beneficial interest beyond the period provided for in the original trust. Accordingly, we conclude that State Court order will not cause Family Trust or Trusts 1a, 1b, 1c, 1d, and 2a to lose their exempt status for generation-skipping transfer tax purposes and will not subject either a distribution from or termination of any interest in the Family Trust or Trusts 1a, 1b, 1c, 1d, and 2a to GST tax under § 2601.

Ruling Request 2

Section 2501(a) imposes a tax on the transfer of property by gift by an individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

In the instant case, after the partition of Family Trust into five partitioned trusts, each beneficiary of a partitioned trust will have the same beneficial interest as he or she had under Family Trust. In particular, in view of the composition of each primary beneficiary's family line, each beneficiary will receive the same interest on termination of the respective trust under the terms of the State Court Order, as they would have received under the terms of Family Trust prior to the partition. Because the beneficial interests of the beneficiaries are the same both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the partition. Accordingly, we conclude that State Court order will not constitute a transfer by any beneficiary of Family Trust or of Trusts 1a, 1b, 1c, 1d, or 2a that would be subject to gift tax under § 2501.

Ruling Request 3

Section 61(a)(3) of the Internal Revenue Code (the Code) provides that gross income includes gains derived from dealings in property.

Section 1001(a) of the Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 of the Code for determining loss over the amount realized.

Section 1001(b) of the Code states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c) of the Code, except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001 of the Code, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56- 437, 1956-2 C.B. 507.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution. The issue presented was whether a sale or exchange that has taken place results in the realization of gain or loss under § 1001 of the Code.

The Court concluded that § 1.1001-1 of the Income Tax Regulations constitutes a reasonable interpretation of § 1001(a) of the Code. Further, the Court concluded that an exchange of property gives rise to a realization event under § 1001(a) of the Code if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a) of the Code, the Court stated that properties are "different" in the sense that is "material" to the Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings Ass'n v. Commissioner, 499 U.S. at 564-65. The Court concluded that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and therefore the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

In the present case, the Family Trust will be partitioned on a pro-rata basis. Except for the partition, all of the operating provisions of the Trust will remain unchanged. Accordingly, under the proposed transaction, Family Trust will be partitioned but the beneficiaries' interests in the property will not change in kind or extent and no new interests will be created. Consistent with the Supreme Court's opinion in Cottage Savings, we conclude that the interests of the beneficiaries of Trusts 1a, 1b, 1c, 1d, and 2a will not differ materially from their interests in the Family Trust.

Therefore, the proposed partition of Family Trust will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries and will not result in recognition of gain or loss under § 61 or 1001 of the Code by the Trust, the resulting partitioned trusts, or a beneficiary of the Trust or of the resulting partitioned trusts.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In addition, we express or imply no opinion regarding the value of the property transferred to the trust.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Each ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

George Masnik
Chief, Branch 4
(Passthroughs & Special Industries)

Enclosures
Copy for section 6110 purposes
Copy of this letter

cc: